

— October 15, 2003 —



# Acquisition

Government Source Inspections  
(D-2004-011)

— Department of Defense —  
Office of the Inspector General

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## **Acronyms**

DLA	Defense Logistics Agency
DCMA	Defense Contract Management Agency
FAR	Federal Acquisition Regulations



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October 15, 2003

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,  
TECHNOLOGY, AND LOGISTICS  
DIRECTOR, DEFENSE CONTRACT MANAGEMENT  
AGENCY

SUBJECT: Report on Government Source Inspections (Report No. D-2004-011)

We are providing this report for review and comment. The Under Secretary of Defense for Acquisition, Technology, and Logistics did not respond to the draft report; however, we considered comments from the Director, Defense Contract Management Agency when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request that the Under Secretary of Defense for Acquisition, Technology, and Logistics provide comments to the recommendations in this report by December 1, 2003.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to [Audcm@dodig.osd.mil](mailto:Audcm@dodig.osd.mil). Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Nicholas E. Como at (703) 604-9215 (DSN 664-9215) or Mr. Terry L. McKinney at (703) 604-9208 (DSN 664-9208). See Appendix B for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

*Robert K. West*

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Deputy Director  
Contract Management Directorate

# Office of the Inspector General of the Department of Defense

**Report No. D-2004-011**

(Project No. D2002CF-0169)

**October 15, 2003**

## Government Source Inspections

### Executive Summary

**Who Should Read This Report and Why?** The DoD acquisition and contracting community as well as members of quality assurance, technical, and engineering functions who support DoD weapon systems should read this report. The report provides insight into the expectations, appropriateness, and realities of Government source inspections.

**Background.** Federal regulations require that agencies provide quality assurance to ensure that supplies and services meet contract requirements. Inspection of supplies or services before transfer or acceptance is a key facet of the DoD quality assurance program. Inspection generally occurs at either the point where goods are made or assembled (source inspection) or at the DoD activity receiving the finished product (destination inspection). Federal regulations do not define a source inspection nor do they designate a primer for the steps involved during a source inspection. Instead, engineers, contractors, contracting officers, or quality assurance specialists determine the location and extent of a source inspection.

The Defense Contract Management Agency (DCMA) conducts source inspections. Quality assurance specialists work at either a contractor plant or a DCMA office (in which case, each specialist is responsible for overseeing the work of several contractors). In 9 of the 10 DCMA offices we visited, more than 40 percent of the specialists were located in contractor plants. In FY 2002, DCMA employed 2,846 quality assurance specialists, down from the 3,797 quality assurance specialists employed in FY 1998. In the last 5 years, the DCMA workforce decreased about 25 percent.

On May 29, 1997, the Under Secretary of Defense (Comptroller) issued DoD Management Reform Memorandum Number 10, "Redesigning Department of Defense Source Acceptance Policies and Procedures." The memorandum directed that the Military Departments and DoD agencies review existing stock items designated for a Government source inspection. After that review, a process action team recommended that the Military Departments and DoD Agencies eliminate source inspection requirements for about 158,000 of the 442,000 procurements. Regulatory guidance was subsequently changed requiring contracting activities to consider factors such as a contractor's production and quality history in conducting an inspection at source rather than at destination.

**Results.** Steps the Under Secretary of Defense (Comptroller) took to reduce source inspection had merit; however, reform has not occurred and DoD needs to relook at its overall quality assurance program. Recent changes in the DoD Acquisition strategy—from acquiring goods and services based upon rigid specifications to a more commercial approach—has changed the quality assurance environment. In addition, communication breakdowns among DoD program offices, procurement activities, and

quality assurance personnel resulted in either unnecessary Government source inspections or inspections of questionable value. Our review of 518 contracts for FY 2001 requiring source inspections showed that as many as 172 inspections provided either nominal or no value to the DoD quality assurance process. Further, an additional 254 inspections provided questionable value because the contracts did not have a quality assurance letter of instruction or a quality deficiency report. The results of most in-plant inspections showed few deficiencies. As a result, the Government was using resources to perform inspections that resulted in very little value added.

To provide a more meaningful quality assurance program, the Under Secretary of Defense for Acquisition, Technology, and Logistics should define what is involved in conducting a source inspection versus a destination inspection. The Under Secretary should also define item criticality for non-aviation critical items, address source inspection requirements for commercially procured items and procurements from distributors, and prohibit source inspections for commercial-off-the-shelf items. In addition, the Under Secretary should require that DoD procurement activities respond to DCMA requests for changes in source inspection requirements as well as determine the need for the use of both the Certificate of Conformance and Alternate Release Procedure methods. To maximize the effective use of DCMA resources, the Director, DCMA should, on a

risk-based approach, focus its inspections on new contractors, small contractors, and contractors with known quality problems. The Director should also require that DCMA personnel request procurement activities to change source inspection requirements when appropriate and establish metrics that identify those activities that do not respond to the requests. Finally, the Director, DCMA should instruct its quality assurance specialists on how and when to implement the Certificate of Conformance and Alternate Release Procedures (See the Finding section of the report for detailed recommendations).

We reviewed the management control program as it related to Government source inspections. Management controls did not ensure that formal notifications of changes in source inspection requirements were properly submitted or promptly acted upon.

**Management Comments and Audit Response.** We provided a draft of this report on June 30, 2003. The Under Secretary of Defense for Acquisition, Technology, and Logistics did not respond to the draft report. Therefore, we request that the Under Secretary of Defense for Acquisition, Technology, and Logistics provide comments to the recommendations in this report by December 1, 2003.

The Executive Director, Contract Management Operations, DCMA either concurred or partially concurred with the recommendations. For the partially concurred recommendations, the Executive Director proposed alternative actions. We agree with the proposed alternative actions in monitoring the effective use of DCMA quality assurance specialists and in the reporting of contract deficiencies involving a requested change from source to destination inspection. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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## Background

Federal Acquisition Regulation (FAR) Section 46.102, “Policy,” requires that agencies include in contracts inspections and other quality requirements that will protect the interest of the Government. FAR Section 46.104, “Contract Administration Officer Responsibilities,” makes the contract administration office responsible for performing any action necessary to verify whether the supplies or services conform to contract quality requirements. FAR Section 46.402, “Government Contract Quality Assurance at Source,” and FAR Section 46.403, “Government Contract Quality Assurance at Destination,” both describe circumstances for conducting an inspection at either a source or a destination. After completing an inspection, the Government agent signs a DD Form 250, “Material Inspection and Receiving Report,” which authorizes acceptance and shipment of the item. However, the FAR does not define source inspection or designate a primer of what should be done during an inspection.

In-house engineering or weapon system program personnel advised the contracting officer of the type of inspection required. The contracting officer then incorporated any specific requirement in the contract. We could not find, however, criteria requiring that the contracting officer document why a contract required a source inspection. Contractors also had input on the type of inspection, and often preferred source inspections because the contractors were paid faster for the items purchased.

After a contract is awarded, the contract is either sent to the Defense Contract Management Agency (DCMA) for administration (including quality assurance) or is managed by the Military Service purchasing the items. When specific instructions (quality assurance letters of instruction) are not provided and the contract requires a source inspection, the specialist determines the type and depth of the inspection. The DCMA *One Book*, September 1999, provides policy to DCMA for the performance of contract management functions, including quality assurance. The DCMA assigns the contract to a quality assurance specialist who has the appropriate technical certification for conducting the required inspection. The specialist reviews the contract to determine the specific inspection requirements. The specialist also reviews the contractor’s manufacturing and quality history about the item. The specialist may also inspect any special packaging requirements for the item. The inspections that the quality assurance specialist conducts vary depending on the company’s history, inspection requirements, and the type of and criticality of the item purchased.

**Types of Source Inspections.** Three types of source inspections—physical inspection of finished items, inspection of the processes within the facilities, and a simple observation of kind, count, and condition—were conducted.

**Physical Inspections.** Physical inspections require that quality assurance specialists select a manufactured item or a sample of manufactured items and inspect that item to a specification, drawing, or other instruction. If inspection instructions are not available, a specialist can inspect the item or items at their

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discretion. A specialist generally tries to determine the most critical characteristic or function for a particular item and performs a variety of measurements.

More detailed inspection instructions are provided through a quality assurance letter of instruction. The letter is prepared by a purchasing office or a technical activity regarding a specific product or process specifying the type and extent of inspection to be performed on a specific contract for specific supplies or services. The quality assurance letters of instruction we reviewed were instructions for a physical inspection of items.

**Contractor Processes.** DCMA uses process-proofing inspections and product audits as a part of its source inspection process. Process-proofing inspections consist of assessing contractor processes and production line procedures to establish confidence that procured items produce the desired outcome, and that process-proofing identifies areas of high risk and helps reduce reliance on a final inspection. To accomplish process-proofing inspections, the quality assurance specialist must assess:

- the contractor's workforce skill levels,
- the adequacy of the contractor's machinery and materials, and
- contractual requirements to be met.

The DCMA *One Book* requires that product audits be conducted on moderate and high-risk processes. DCMA Pratt-Whitney, Hartford, Connecticut, identified a product audit as, "examinations or test of processes which can be product hardware or associated control system documents." Other DCMA specialists defined product audits as inspecting an item for compliance with drawings or specifications and inspecting for dimensional and workmanship compliance.

**Kind, Count, and Condition.** Quality assurance personnel also perform an inspection called kind, count, and condition. That method only superficially evaluates the quality of an item and consists of:

- visual identification of at least one item per item description, verification of part number, contract number, and National Stock Number (kind);
- visual confirmation of contents of one package per line item and number of packages received (count); and
- visual verification of physical appearance (condition).

**Management Reform Memorandum No. 10.** On May 29, 1997, the Under Secretary of Defense (Comptroller) issued DoD Management Reform Memorandum No. 10, "Redesigning Department of Defense Source Acceptance Policies and Procedures," which directed a reassessment of the DoD source acceptance policies and procedures. The memorandum directed that the Under Secretary of Defense for Acquisition and Technology, the Military Departments,

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DCMA, and the Inspector General of the Department of Defense account for Government steps and costs in the source acceptance process, and then compare those steps and costs to alternative methods. The memorandum further directed that a task force undertake a review to ascertain if they should retain the source designation of the existing stock items.

On September 24, 1997, the Under Secretary of Defense for Acquisition and Technology issued the source inspection review plan the process action team task force recommended. The plan states that although source inspections are an important safeguard for ensuring the quality of DoD material, the inspections represent a significant cost for the acquisition system and must be incurred only when appropriate. Source inspections should be the exception rather than the rule, especially when the contractor has good quality history. The review plan required revalidation of source inspected items, and the Military Departments, Defense agencies, and DoD field activities were tasked to review supply items bought in FY 1998 and FY 1999. The plan required that engineering support activities respond to requests for reevaluating critical item determinations. The Military Departments and the Defense Logistics Agency (DLA) reviewed more than 442,000 items between January 1998 and March 1999. The review identified more than 158,000 items changing the inspection location from source to destination. DLA revised its existing regulations that were designed to streamline the source inspection process.

**Source Inspection Decision Guide.** To ensure successful implementation of Management Reform Memorandum No.10, the process action team task force developed the “Government Source Inspection Decision Guide.” The decision guide factors in the quality history of a company when recommending whether to conduct a source inspection. Based on the type of quality history of the contractor plus characteristics listed under each category, one could determine the recommended type of inspection. Only two buying commands implemented a version of the Government Source Inspection Decision Guide into its source inspection criteria.

## Objectives

Our objective was to determine whether source inspections were performed on purchases that did not require them. Specifically, the audit identified Military Department and DLA procurements in which the need for source inspection was determined as unnecessary or questionable. We also reviewed the management control program as it related to the overall objective. See Appendix A for a discussion of the scope and methodology, our review of the management control program, and prior audit coverage related to the objectives.

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## DoD Management of Government Source Inspections

DoD could have made better use of quality assurance resources by assessing its use of quality assurance specialists and better defining its policies and procedures relating to source inspections. Communication breakdowns among program offices, procurement activities, and quality assurance activities led to:

- ambiguity in the level and extent of requested source inspections;
- inconsistent and unclear application of items defined as critical or having a critical application;
- inconsistent implementation of inspection procedures for commercial items; and
- arbitrary and inconsistent inspection procedures for items purchased from distributors.

As a result, DCMA resources were not used wisely and confusion existed for the user regarding assurances. In addition, as many as 426 of 518 contracts for FY 2001 that we reviewed received either nominal inspection, no inspection, or inspection where the value added to the procurement process was questionable.

## Criteria

**Government Inspection Responsibilities.** FAR Part 46, “Quality Assurance,” prescribes the general policies and procedures for Government source inspections. FAR Section 46.103, “Contracting Officer Responsibilities,” states that contracting offices must establish technical specifications for inspections, testing, and other contract quality requirements. The specifications include issuance of instructions to the contract administration office that will ensure integrity of the supplies procured. FAR Subpart 46.2, “Contract Quality Requirements,” mandates that contracting officers establish the “appropriate quality requirements.” The contracting officer can establish a range of quality control procedures—from inspection at the time of acceptance to a requirement for the contractor to implement a program for quality assurance. FAR Section 46.402 states when a source inspection must be performed. An inspection is conducted at the source location if:

- performance at any other place would require uneconomical disassembly or destructive testing;

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- considerable loss would result from the manufacture and shipment of unacceptable supplies or from the delay in making necessary corrections;
- special required instruments, gauges, or facilities are available only at source;
- performance at any other place would destroy or require replacement of costly special packing and packaging;
- Government inspection during contract performance is essential; or
- it is determined for other reasons to be within the best interest of the Government.

However, the FAR does not clearly define exactly what a source inspection entails. The contracting officer does not operate in a vacuum. Instead, the contracting officer receives assistance from system engineers, contractors, and users about the degree of quality inspection needed.

Government inspections at a destination location are outlined in FAR Section 46.403. Specific factors that warrant inspection at destination include commercial-off-the-shelf items requiring no technical inspection, whether the item is perishable or controlled by other Federal regulatory agencies and the availability of test equipment is located at destination. The FAR section does not further define a general factor addressing whether inspection at destination is in the Government's best interest.

Defense FAR Supplement Paragraph 246.103(2)(c) states that the activity responsible for technical requirements may prepare instructions on the type and extent of Government inspections for acquisitions that are complex, have critical applications, or have unusual requirements. The regulation is unclear about whether the instruction applies to a general inspection, a quality assurance letter of instruction, or a Government source inspection. The regulation requires that when preparing instructions for technical requirements the technical activity must consider the criticality of material procured in relation to intended use. In addition, consideration must be given to the quality history of the contractor, problems encountered in development of the material, problems encountered in other procurements of the same or similar material, feedback data, and experience of other contractors in overcoming manufacturing problems. The instructions must be prepared on a contract-by-contract basis and not serve as a substitute for incomplete contract quality requirements. After issuing the instructions, the technical activity must provide the contract administration office available information regarding those factors that resulted in the requirement of Government inspection and must periodically analyze the need to continue, change, or discontinue the instructions.

**DCMA Guidance.** The DCMA *One Book* provides quality assurance guidance for DCMA specialists. It states that if a contract is awarded as a commercial contract and the quality assurance requirement clause of FAR Clause 52.212-4,

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“Contract Terms and Conditions–Commercial Items,” is listed in the contract and addenda are included, then the surveillance by DCMA is limited to the addenda. If addenda are not included, surveillance by DCMA is limited to inspection and test after offered for acceptance. Furthermore, if surveillance is limited to kind, count, and condition, the quality assurance specialist should issue a DD Form 1716, “Contract Data Action Recommendation/Deficiency Report,” to change the point of inspection to destination. The DCMA *One Book* also describes policy regarding quality assurance of distributors.

A distributor is defined as a supplier whose primary business is to purchase, stock, sell, or distribute items manufactured by others, including original equipment manufacturers. The DCMA *One Book*, Chapter 4, “Quality Assurance and Product Acceptance Services,” addresses quality assurance for distributors and provides guidance for determining whether source inspection procedures can be implemented on items procured from distributors. The guidance for source inspections is based on identifying the business as a distributor, the availability of technical data packages, drawings, specified Government or contractor test and acceptance procedures, and the practicability of conducting a source inspection at the distributor’s location. The practicality of conducting source inspections with a distributor is based on whether the key characteristics of the procured item can be assessed at the distributor’s location.

**Item Criticality.** The extent of Government source inspections is usually based on the classification of the contract item or service as determined by its technical description, complexity, and criticality of application. FAR Section 46.203, “Criteria for Use of Contract Quality Requirements,” classifies item technical descriptions as either commercial or Military-Federal unique, depending on whether the item is described in a commercial catalog or drawing, or a Government drawing or specification. Complex items are defined as having quality characteristics, not wholly visible in the end item, for which contractual conformance must be established progressively through precise measurements, tests, and controls applied during the manufacturing and in the functional operation. Item criticality requires the most in-depth analysis and decision. The most common definition of a critical application item is an item in which failure could injure personnel or jeopardize a vital mission of an agency. A noncritical application item is any other application.

DLA Directive 3200.1, “Engineering Support for Items Supplied by DLA and General Services Administration,” dated October 28, 1994, provides a definition of a critical application item. The directive stipulates that a critical application item is essential to weapon system performance, operation, or the preservation of life and safety of operating personnel. The directive applies to all DoD procurements and further states that the Military Departments are responsible for identifying critical application and weapon system items.

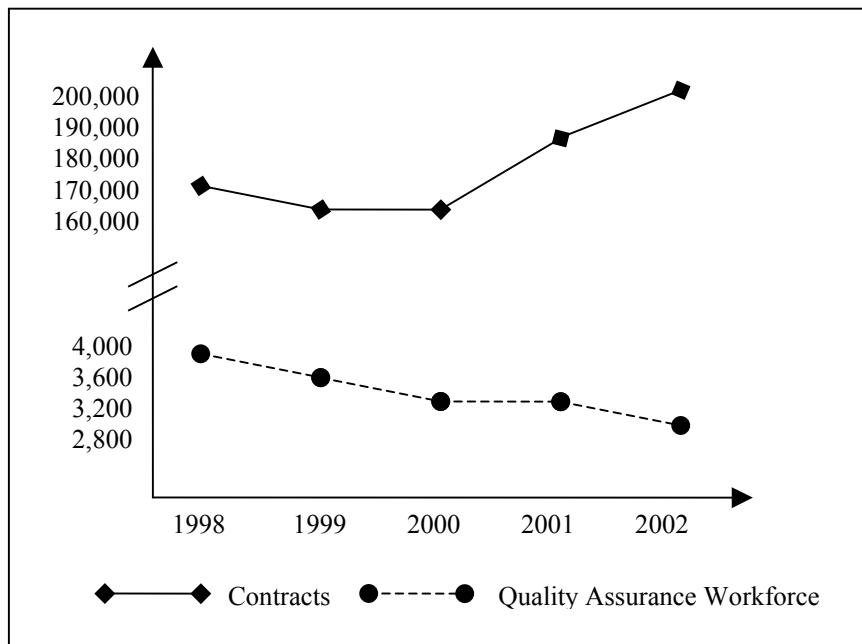
**Regulatory Criteria for Commercial Items.** The FAR defines a commercial item as any item that is of a type the general public customarily uses. The item may be modified from a type customarily available in the commercial marketplace to meet Federal Government requirements. FAR Section 12.208, “Contract Quality Assurance,” states that contracts must rely on the contractor’s

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existing quality assurance systems in lieu of a Government [source] inspection unless the commercial practices include in-process inspections. The reliance on the contractor's existing quality assurance system is considered the accepted commercial practice for procurement of commercial items. However, FAR Clause 52.212-4 defines the commercial item procurement process and stipulates that the Government reserves the right to inspect or test any supply offered for acceptance. The DCMA *One Book* addresses the practicality of the role of the quality assurance specialist as well as commercial items and states that the "Government will not perform surveillance prior to the time the contractor tenders commercial items for Government acceptance."

## Quality Assurance Workforce

The DCMA quality assurance workforce was reduced from 3,797 in FY 1998 to 2,846 in FY 2002, a reduction of about 25 percent, while contract administrative workload increased from approximately 170,000 contracts to nearly 200,000 contracts during the same period. Figure 1 depicts the DCMA Quality Assurance workforce and corresponding workload during FY 1998 through FY 2002.



**Figure 1. DCMA Workload and Quality Assurance Workforce**

**DCMA Workload and Workforce Trends.** The Individual Contracting Action Data Base reported that in FY 1998 DoD awarded approximately 260,000 contracts to about 31,000 contractors, and in FY 2002 awarded approximately 473,000 contracts to about 47,000 contractors. In 5 years, the

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number of contractors increased overall by 50 percent while quality assurance specialists decreased by 25 percent. A closer look at this trend shows that small business procurements (procurements valued at less than \$5 million) have increased at a greater rate (67 percent).

Another factor affecting the future effectiveness of the DCMA quality assurance program is the average age of the DCMA workforce. The average age of DCMA quality assurance specialists is 52.6 years, as extracted from the DCMA Cognos Powerplay Web explorer by headquarters, DCMA personnel. Although the specialists are not required to retire at age 55, many of the specialists will be eligible to retire. Therefore, the potential loss of expertise by the current specialists is a realistic possibility. For example, in FY 2002 DCMA Indianapolis, Indiana, lost through retirement 17 quality assurance specialists. The office did not replace the retired specialists.

We asked several of the DCMA offices visited for workload statistics. Of those offices, two reported that the ratio of contracts to quality assurance specialists increased between FY 1997 and FY 2002. DCMA Santa Ana, California, reported that the ratio increased from 117 to 1 in FY 1997 to 165 to 1 in FY 2002, and DCMA Twin Cities, Minnesota, reported the ratio increased from 37 to 1 in FY 1997 to 64 to 1 in FY 2002. The increase in the number of contractors doing business with DoD shows the success of DoD shift in acquisition strategy from a military specification environment to using commercial practices. As a result of that trend, the Director, DCMA should reconsider how best to use its quality assurance personnel. Items that need addressing are: (1) the types and quality of inspections needing to be performed in light of most items being deemed as commercial, and (2) the location where the resources should be focused (in contractor plants or smaller companies).

**DCMA Workforce Dispersion.** For 9 of the 10 DCMA sites we visited, 313 of the 760 quality assurance specialists assigned to those offices were assigned to a contractor plant. That amount represents a significant percentage of the workforce tied to a particular location. If the company is producing good products and especially if the company is producing mostly commercial items, DCMA should use a more risk-based approach and consider shifting resources from in-plant sites to poor performers, new contractors, and small contractors providing truly critical items. For example, two quality assurance specialists were assigned to a large contractor's distribution plant for commercial parts. The specialists could only verify that the company was inspecting manufactured items entering the receiving department and that the items were packaged and addressed properly. We believe that the resources could be better used.

Generally, the quality assurance responsibilities of the in-plant specialist remain unchanged even if the number of contracts awarded to the contractor increase. The workload would not increase because the specialist is responsible for overseeing the contractor's manufacturing processes versus inspecting each manufactured item. Conversely, the nonresident specialists must be familiar with the quality assurance processes and contract histories of multiple contractors. As the number of companies contracting with DoD increases, the responsibilities of the nonresident specialist will also increase. For example, one nonresident

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specialist we interviewed provided oversight on 20 different contractors involving 167 contracts. DCMA should consider reallocating specialists to assist nonresident specialists in meeting increasing inspection requirements. DCMA quality assurance resources should be reallocated based on the ongoing DoD effort to buy commercial items and use performance-based contracting. Neither of those buying philosophies requires that military specifications be used to manufacture items.

DoD is not the only organization that provides quality assurance oversight to large contractors. The International Organization of Standardization, the Federal Aviation Administration, and the contractor's in-house quality assurance department also provide oversight. The International Organization of Standardization is a worldwide quality management system that is implemented by individual contractors. Once a contractor is registered with the International Organization of Standards, the contractor must be periodically re-certified. The Federal Aviation Administration inspects aircraft part manufacturers. Large contractors also implement in-house quality assurance procedures, including process-proofing reviews of manufacturing processes and product audits. DCMA in-plant quality assurance specialists generally conduct process-proofing reviews and product audits at the same time as the contractor quality assurance representatives conduct their reviews. In effect, the DCMA specialists are evaluating the contractor quality representatives, not the quality systems of the contractors.

A recent initiative between Raytheon and the Government resulted in elimination of source inspections at the Raytheon Tucson, Arizona, plant. The Government decided to eliminate any surveillance of the low-risk processes from purchase orders and estimated that it reduced workload by 5,000 work hours. The elimination of inspections was accomplished in two segments. The first segment actually eliminated source inspection at Raytheon, concentrating surveillance efforts in evaluating Raytheon's suppliers. The inspection elimination plan focused on using Raytheon source inspectors to monitor supplier processes during the build-up of a product, instead of inspecting the end item. The second segment eliminated source surveillance of the suppliers where possible because the process was redundant to the Raytheon verification process.

## Universe of Contracts Reviewed

Our review included 518 FY 2001 contracts that contained requirements for source inspections. The 518 contracts included 139 Army contracts, 102 Navy contracts, 136 Air Force contracts, and 141 DLA contracts. We reviewed the contracts and interviewed engineering and contracting personnel at 12 procurement locations. We also visited 10 DCMA locations that provided contract administration for 255 of the contracts we reviewed. At the 10 DCMA locations, we interviewed 156 quality assurance specialists to determine the type and extent of the source inspection conducted. We also e-mailed an additional 37 DCMA locations to obtain source inspection information for 263 contracts. We segregated the 518 contracts for FY 2001 by those contracts that contained a

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criticality designation for the procured items. We identified 253 of the 518 contracts for which criticality was not designated in the contract documents or by the contracting officer. Of the 518 contracts, 21 contracts identified nuclear or submarine characteristics and received the required level of inspection. The 21 nuclear and submarine contracts were justified source inspections. The remaining 244 contracts cited item criticality.

A history of the contractor's quality is another major part of determining whether a source inspection should be required, and if required, the depth of the inspection. One of the 12 procurement sites stated that a source inspection was conducted because of the past quality deficiency reports for 10 of the contracts located at the site. Only 4 of the 10 contracts received a higher-level source inspection.

For 58 of the 518 contracts, the DCMA quality assurance specialist identified a nonconforming item during the source inspection. When found, the contractor fixed the nonconformance before the Government accepted the items. A physical nonconforming feature existed in at least 27 of the 58 contracts. The physical nonconformances included paint problems, clothing irregularities, incorrect calibration, and improper materials employed. The 58 contracts included 39 separate contractors, of which at least 13 contractors had DCMA quality assurance specialists assigned at the plant.

For 125 of the 518 contracts, problems had been identified during previous source inspections. The 125 contracts included 80 separate contractors where at least 25 contractors had a quality assurance specialist on-site.

Only 50 of the 518 contracts identified quality deficiency reports issued by users. The 50 contracts that received quality deficiency reports were comprised of 43 different contractors. Of the 43 contractors, at least 12 had a DCMA quality assurance specialist on site at their location performing the source inspections.

## **Contracts Not Designating Criticality**

For the 253 contracts that did not designate item criticality, we found the following:

- 43 contracts were source inspected that had specific inspection procedures (quality assurance letters of instruction) or contractors were cited with quality deficiency reports.
- 90 contracts were either nominally inspected (for example, kind, count, and condition type inspections or lower-level inspections) or no source inspection was performed. Items included air assembly compressors, circuit card assemblies, and maintenance kits.

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- 120 contracts received a source inspection that added questionable value. No evidence was presented that the contractors had prior quality deficiency reports, and the contracts provided no guidance to DCMA as to what needed inspected. Items included serge cloths, seat cushions, and a detector assembly tube.

**Nominal or No-source Inspection.** For 90 contracts, little or no value was added to the quality assurance process for a nominal inspection that included a kind, count, and condition inspection, or when no inspection was conducted. We believe that a nominal type of inspection provided no additional value and could be performed at destination. Furthermore, source inspections performed on commercial items depletes part of the savings realized by purchasing commercial items. As a result, we believe that the inspections should be conducted at destination.

**Commercial Items Considered “Off-the-Shelf.”** Procurement activities requested source inspections for 5 of the 90 contracts receiving a nominal inspection that were considered to be commercial-off-the-shelf items. However, FAR Section 46.403 stipulates that inspections shall be performed at destination for supplies purchased off the shelf that require no technical inspection. For example, we reviewed a contract at DCMA Santa Ana for a commercial-off-the-shelf cover assembly sensor. The contract originally required inspection at destination. To expedite payment processing, the contractor requested the inspection at source. The contract was modified to include the source inspection requirement. However, the quality assurance specialist performed only a kind, count, and condition type inspection that provided minimal value added to the quality assurance process and should have been performed at destination.

**Questionable Source Inspections.** Of the 253 noncritical contracts reviewed, 120 had a questionable source inspection requirement because DCMA noted that the contractors did not have prior quality deficiency reports, which would indicate a good quality history. Questionable source inspections were conducted on items such as a serge cloth, a firefighting rescue truck, a brake valve, a truck-mounted crane, pneumatic tire wheels, and seat cushions. In addition, the contracts did not have quality assurance letters of instruction providing mandated guidance to DCMA. As a result, the quality assurance specialist performed a level of inspection that they felt adequate. We do not know whether the inspection the quality assurance specialist completed was the inspection intended by the procurement activity or by system engineers. A more in-depth look at the 120 contracts showed that 61 of the contracts were for commercial items or for items purchased from distributors. We question if there was any value added to the process by the inspections. The Defense FAR Supplement 246.103(2)(c) states that the technical office should consider past quality history and criticality of an item before preparing inspection instructions. The 120 contracts did not identify the item as critical, and, furthermore, DCMA had no record of quality deficiency reports on these items.

**Procured Commercially.** Procurement activities requested source inspection for 59 commercial contracts without a criticality designation, and DCMA documented that the contractors had a good quality history. For example,

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questionable source inspections were conducted on items such as a relay valve, propeller shaft, a disc brake rotor, and a direct access storage device. Furthermore, our review of the inspections showed no deficiencies disclosed. We believe that if items were deemed commercial and sold in the commercial market place, inspection requirements could generally be reduced. That concept is one of the major advantages to purchasing items from commercial sources.

## Contracts Designating Criticality

We reviewed 244 contracts that designated item criticality and determined that:

- 28 contracts were source inspected that had a quality assurance letter of instruction or had quality deficiency reports issued on prior purchases.
- 82 contracts were either nominally inspected or no source inspections were performed (for example, kind, count and condition type inspections, lower-level inspections and no inspections conducted).
- 134 contracts received a source inspection that added questionable value. The contractors did not have prior quality deficiency reports and these contracts did not have mandated inspection guidance to DCMA.

**Commercial Items.** Of the 82 contracts that were nominally inspected or where no inspection was performed, 43 were for commercial items. We reviewed 3 of the 43 commercial item contracts at DCMA – Hamilton Sundstrand, Windsor Locks, Connecticut, for the procurement of a retainer connecting rod, alternating current oil-cooled generator, and motor parts. The contracts did not include source inspection instructions or requirements; however, the procurement activities at Tinker Air Force Base, Oklahoma, and Hill Air Force Base, Utah, deemed the items critical.

The quality assurance specialists at the plant assessed only the contractor's past performance and determined that the items would be accepted based on the contractor's self-certification. Accordingly, personnel in the program office and procurement activities may have a false sense of security in what the source inspection is accomplishing. In addition, we visited seven plants, and only two plants reported quality deficiency reports for the items selected for review. Again, if a contractor shows a history of producing good quality parts, DCMA could consider reducing or eliminating its quality resources at such locations and concentrating in other problem areas.

**Questionable Source Inspections.** For the 134 contracts receiving a source inspection that added questionable value, DCMA noted that the contractors did not have prior quality deficiency reports, which is an indication of good quality history. The Defense FAR Supplement states that the technical office should consider quality history and the criticality of the item related to its intended use in

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preparing instructions. In addition, the contracts did not have quality assurance letters of instruction providing mandated guidance to DCMA. As a result, the quality assurance specialist performed a level of inspection that they felt adequate. We do not know whether the inspection the quality assurance specialist completed was the inspection intended by the procurement activity or by system engineers. Furthermore, 65 of the contracts were for commercial items and 6 were for commercial items obtained from distributors. For example, procurement activities

required that DCMA perform source inspections on socket head screw caps, access covers, machine screws, rollers, filler opening caps, pneumatic tires, and nonmetallic hose assemblies.

**Procured from Distributors.** For the items obtained from the distributors, the quality assurance specialists did not have the technical information available to help identify which key characteristics constituted the item's criticality. Even if technical information were available, measuring devices, such as gauges or other devices, may not be available at the distributor's location. For example, a DLA contract indicated that a check valve was a critical application item. The distributor's role in this procurement action was to obtain the item from the supplier, package the item, and ship it to the DoD customer. The quality assurance specialist stated that a source inspection for the check valve was meaningless because technical data packages or specified test procedures were not available at the distributor's location. In addition, if the data packages and test procedures had been available, the specialist would have had to open packages that were packed by the original equipment manufacturer.

## Communication Issues

During our visits to contracting activities and DCMA offices, a disconnect was evident between what was expected for a source inspection, including use of alternate release procedures and certificates of conformance and their meanings, the information needed to conduct a good inspection, the requirements for identifying item criticality, and a lack of feedback regarding requests that could reduce inspection requirements.

**Inspection Expectations.** Engineering and procurement activities may not be obtaining the depth and quality of inspections anticipated because of incomplete instructions for DCMA. Engineering personnel may not be getting the inspection they expected. For example, Navy engineers expect that DCMA quality assurance specialists closely scrutinize aircraft components requiring a source inspection. In accepting items from five contracts, DCMA did not inspect the items from those particular contracts. Instead, DCMA relied on surveillance of the contractor's manufacturing processes. Using that method of quality assurance, rather than inspecting manufactured items that are ready for shipment, DCMA provided surveillance of the manufacturing process and conducted periodic product audits of some items at critical stages during manufacture. No indication existed that items from the five contracts were selected for a product audit. The items were manufactured and shipped without a detailed inspection.

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If the procurement activities or the engineers intend the source inspection to closely scrutinize the manufactured item, procurement personnel or engineering personnel must send a quality assurance letter of instruction to DCMA. Without specific instructions, DCMA quality assurance specialists perform the inspection based on their experience with the item as well as with the company. Another area for which inspection expectations may not be what the procurement activities or technical activities expected is the DCMA use of alternate release procedures.

**Alternate Release Procedure.** The Defense FAR Supplement Section 246.471(b), “Alternative Procedures-Contract Release for Shipment,” states that the contract administration office may authorize, in writing, the contractor to release supplies for shipment when:

- the stamping or signing of the shipping papers by a representative of the contract administration office interferes with the operation of the Government contract quality assurance program or takes too much of the Government representative’s time;
- sufficient continuity of production exists that permits the Government to establish a systematic and continuing evaluation of the contractor’s control of quality; and
- the contractor has a record of satisfactory quality, including that pertaining to preparation for shipment.

Alternate release procedures require that the contractor certify that the item or items were subjected to, and passed all examinations and tests required by the contract, conform to the quality and condition identified in the contract, and were shipped in accordance with the shipping instructions. Although the procedure may require DCMA quality surveillance during the manufacturing process, DCMA may not have been present when the items were completed and finished. While such a practice may be acceptable for commercial or noncritical items, the practice may not be practicable for critical items for which the procurement or engineering activities required inspection be conducted before shipment.

The Defense FAR Supplement does not state that the contract administration office is required to notify the procurement or engineering activity when placing a contractor on the alternate release program. If an item is critical, DCMA should notify the procurement activity and the engineering activity of its intention to place the contractor on the alternate release program. Of the 244 critical contracts reviewed, 32 used alternate release procedures. Furthermore, 20 of the items using alternate release procedures were for contractors in which DCMA conducts process proofing mentioned above. As a result, the possibility exists that the DCMA quality assurance specialist never touched or inspected the items. A second method of release without inspection was a certificate of conformance.

**Certificate of Conformance.** FAR Section 46.504, “Certificate of Conformance,” states that contracting officers may insert a certificate of conformance clause in the contract under certain instances instead of source

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inspection (whether the contract calls for acceptance at source or destination). A certificate of conformance can be used when:

- acceptance on the basis of a contractor certificate of conformance is in the best interest of the Government;
- small losses would be incurred in the event of a defect; or
- based on the reputation of the contractor or past performance, it is likely that the supplies or services furnished will likely be acceptable and any defective work would be replaced, corrected, or repaired without contest.

In no case shall the rights of the Government to inspect supplies under the inspection provisions of the contract be prejudiced.

FAR Section 46.504 is similar to alternate release procedures, with the exception that the contracting officer must place the FAR clause for certificate of conformance in the contract, whereas DCMA can place a contractor on alternate release procedures without the knowledge of the procurement contracting office. The similarity of the two methods caused confusion among the quality assurance specialists we interviewed. For example, one specialist did not know the difference between the certificate of conformance and alternate release procedures. In two offices, specialists misinterpreted the requirements of the certificate of conformance. Both specialists believed that if they used a certificate of conformance for a contract instead of conducting a source inspection they would forfeit the right to enter the contractor's facility. However, the FAR states that if a certificate of conformance is used, the rights of the Government to inspect supplies of the contract shall not be prejudiced.

DCMA can use alternative release or certificate of conformance procedures to reduce source inspections on noncritical and commercial items with a good quality history. If the procedures are to be used on critical items, DCMA should communicate with engineering personnel before proceeding with the action. DCMA also needs to instruct its quality assurance specialists on the quality assurance rights of the Government if procedures are implemented. DoD should determine if it needs both the certificate of conformance and alternate release procedure.

**Inspection Information.** Procurement activities did not provide detailed information to the DCMA quality assurance specialist for the type and depth of inspection required. Because a quality assurance letter of instruction was included in only 5 of the 518 contracts, DCMA quality assurance specialists conducted the inspections at his or her discretion. For example, one specialist was forced to use his best judgment to determine which part of a propeller control arm was critical for that aircraft part. The specialist stated that the item was listed as a critical application item in the DLA-awarded contract but that neither the contract nor the drawings specified exactly what made the propeller control arm critical or exactly what the quality assurance specialist was required to do regarding quality assurance. The specialist, therefore, guessed about what was

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intended when he conducted the inspection and accepted the item on behalf of the Government. Several of the quality assurance specialists we interviewed told us that they believed that the contracting officers were using old contracts and just updating portions of the contracts for cost and purchase information. However, they believed the quality requirements were not updated even when changes had been made to the items being purchased.

**Item Criticality.** Each Service, DLA, and DCMA defines item criticality differently, and those differences of opinion regarding criticality between contracting activities and between DCMA led to confusion. The FAR broadly defines criticality while DLA Directive 3200.1 provides a more detailed definition of a critical application item. The 12 procurement offices we visited provided

18 separate criticality designators such as critical application, flight critical, safety critical, mission critical, critical, life threatening, and criticality “A.” The DCMA received, from DoD procurement activities, conflicting information that affected the degree and expectation of Government source inspections. If the procurement activity requested a source inspection based upon the item’s criticality, DCMA must have the necessary critical characteristics for conducting the source inspection. We identified 27 contracts where a disagreement existed regarding item criticality between the procurement activity and DCMA. For example:

- Three contracts at DCMA Pratt-Whitney were listed as critical or critical application items by the procurement activity as reasons for requesting a source inspection for the procurement of machine screws, internal relay bolts, and shroud assemblies. After reviewing applicable drawings and data at DCMA Pratt-Whitney, the technical assessment group determined that none of the items possessed critical characteristics. The responsible quality assurance personnel did not conduct a final inspection on the items.
- A contract action that procured an electrical access cover requested an inspection at source based on the criticality of the item. The quality assurance specialist contended that the access cover was not a critical application item nor did it have any critical characteristics. The quality assurance specialist conducted a kind, count, and condition type inspection.

Procurement activities had differing opinions regarding item criticality for the same part. The Army awarded a contract for noise insulation blankets. The item was not identified as critical on the Army contract, yet DLA awarded an FY 2002 contract for similar blankets and identified the blankets as critical application items. The only difference between the blankets was their placement inside the helicopter cabin. The quality assurance specialist responsible for the Army contract stated that his opinion was that the blankets were not critical application items. Although drawings existed, the source inspection consisted only of placing the finished blanket over a mold to confirm its dimensions.

The DoD has taken steps to rectify the confusion regarding item criticality and source inspections regarding aviation parts. In August 2002, a joint commanders

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group addressed deficiencies and inconsistencies of terminology, requirements, processes, and operating procedures for the management of aviation critical safety items. The Joint Aeronautical Commanders' Group is comprised of representatives of the Military Departments, DLA, DCMA, the Coast Guard, the National Aeronautics and Space Administration, and the Federal Aviation Administration.

The joint commanders group developed standard policies, terms, and definitions that would cover the life-cycle management of military aviation critical safety items, from the time an item is determined to be critical through its disposal. The group emphasized that for new replenishment items, drawings and technical data must clearly identify that the item is an aviation critical safety item and that the data must identify the critical and major characteristics, critical processes, and inspection requirements for the item. The group also emphasized the essential role of engineering support activities to properly identify or confirm the criticality and associated critical characteristics, manufacturing processes, and quality assurance requirements of all aviation critical safety items, regardless of their status in the DoD inventory. We commend the actions of the Joint Aeronautical Commanders' Group; therefore, no recommendations will be made addressing DoD policy changes for aviation critical safety items.

The Senate Armed Services Committee's report, "National Defense Authorization Act for Fiscal Year 2004," recommends establishing the process to ensure operational safety and effectiveness for all flight safety items. The committee recommended that design activities (Engineering Support Activities) validate the design and technical requirement of all flight safety items and subsequently confirm that flight safety items are procured from sources approved by the design activity and in accordance with technical requirements established by the design activity. A similar review of non-aviation parts would help focus quality assurance to truly required areas, especially in light of dwindling quality assurance resources in DoD.

**Requests for Changes in Source Inspection.** Another area where communication failed occurred between the procurement activities and DCMA with requests for changing the location of the inspection. DCMA has the ability to request that items be changed from a source inspection requirement to a destination inspection when, in their judgment, the DCMA quality assurance specialist believes that either little or no value was added to the quality assurance process. To request a change, the quality assurance specialist prepares a DD Form 1716 and sends that form for action to the procuring contracting officer, through the administrative contracting officer.

DCMA gets virtually no answer, however, from the procuring activities. DCMA quality assurance specialists expressed frustration about not getting a response for changing the location from source to destination. One office has all but given up preparing the forms because of a lack of response. DCMA personnel did not submit a DD Form 1716 for any of the items we selected for review, but we obtained DD Form 1716 records for FY 2001 for two DCMA offices. Of the 125 requests that DCMA Santa Ana issued in FY 2001, the procurement offices responded to only 16. In addition, DCMA Chicago, Illinois, issued 27 requests in

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FY 2001, and procurement offices did not respond to any of the requests. A specialist at the DCMA Santa Ana office submitted 12 DD Form 1716 reports addressing the same contractor and procurement office. The 12 reports contained the following justification for the change from source to destination inspection:

“This contractor is a distributor only. Nothing is manufactured at this facility. This contractor buys items from suppliers and sends them to a packaging house before they are sent to the “ship to” address. These are commercial off-the-shelf items. Recommend this contract and future contracts of this type be modified to have inspection and acceptance at destination.”

The procurement office failed to respond to any of the 12 attempts by the specialist to change the inspection from source to destination. Because the specialist did not receive a response, he was forced, by the terms of the contract, to conduct a source inspection for a pre-packaged, commercial-off-the-shelf item. The inspection consisted of a kind, count, and condition of the item, a task suitable for destination inspection. Requests for changes through the DD Form 1716 can be an effective tool for reducing unnecessary source inspections. The report provides a link between the procurement and engineering activities and the DCMA quality assurance specialist regarding the status of items the activities are purchasing. DoD needs to strengthen this mechanism.

## DoD Initiatives to Reduce Source Inspections

**DoD Initiatives.** The increase in contract administrative workload and reduction in the quality assurance workforce caused both the Principle Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics and the Director, DCMA to take the initiative that would provide an alternative method for reducing the DCMA contract administrative workload. The Principle Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics proposed changes in acquisition business rules that would reduce DCMA workload. In addition, the Director, DCMA proposed alternatives for eliminating or minimizing resources expended on low-dollar value and low-risk contracts as a way to allocate resources to administer higher value and higher risk contracts.

**Proposed Changes in Business Rules.** In September 2002, the Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics stated that source inspections should not be performed on lower value contracts unless specific quality concerns have been identified. The Principle Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics further stated that a common sense approach across DoD is to use human capital resources where value is added. The Deputy Under Secretary proposed the following changes in DCMA business practices that could better align the shrinking contract management resources with the workload:

- Revise Defense FAR Supplement Part 46 to limit Government source inspection on contracts under \$250,000 for when the head of the

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contracting activity approves; significant contract technical requirements exist; critical product features are identified; and the contract is awarded to a manufacturer or producer.

- Eliminate DCMA production surveillance on contracts rated criticality designator “C” (not major system or urgent needs) unless contracting or program offices identify specific concerns to DCMA and request specific production surveillance.
- Discontinue DCMA production quality assurance surveillance on contracts for original equipment manufacturers with continuing production capability unless contracting or program offices identifies specific concerns to DCMA and request specific production and quality assurance surveillance.

**Eliminating or Minimizing Resources on Administering Low-Value and Low-Risk Contracts.** In February and March 2002, DCMA established a Policy and Metrics Streamlining Tiger Team that would explore the concept of either eliminating or minimizing resources expended on administering low-value and low-risk contracts. The team performed pilot tests at selected DCMA sites between June and September 2002. The objective of the pilot test was to determine if contract management activities committed to administering low-value and low-risk contracts could be minimized and resources made available for higher risk contracts.

The team presented the results of the pilot test of low-value and low-risk contracts to the headquarters, DCMA in December 2002. The team concluded that the pilot test of low-value and low-risk contracts successfully demonstrated the ability of DCMA to modify internal processes and adjust resources with little risk for DCMA customers. The team recommended reducing the number of low-value and low-risk contracts delegated to DCMA for management, which would provide opportunity for reallocation of resources to higher-risk contracts. Additionally, the pilot test validated that DCMA provided a costly clean-up role in support of its customers. Correction of the Mechanization of Contract Administration Services database input errors, poorly written contracts, miscoded criticality indicators, and chasing acceptance documents for destination acceptance contracts were described as low-value added to the contract administration process.

DCMA reported that the critical application item designation was inaccurate or unsubstantiated in a vast majority of cases. Several test sites eliminated the critical application designation if not accompanied by additional quality assurance instructions or information. However, the quality assurance specialist still interpreted critical application to receive attention over and above a noncritical item. Unless guidance such as a quality assurance letter of instruction, a technical data package, or a drawing specifying the item’s criticality was provided, the quality assurance specialist would not know the critical characteristics of the item or how to tailor the oversight. If no critical characteristics were identified and the

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contractor had a good quality history, the quality assurance specialist administered the contract as though the critical application designation did not exist. DCMA concluded that the critical application item designation should only be used when:

- consistent definition of item criticality is established;
- clear and consistent expectation for a source inspection is expressed;
- appropriate [contract] clauses are implemented; and
- specific source inspection instructions are provided.

The team stated that the best way to minimize resources on low-value and low-risk contracts was to eliminate them from DCMA contract management inventory altogether. The lack of a singular and consistently applied definition of item criticality has contributed to requests for source inspections that provided minimal value-added to the quality assurance process of the procured items.

In a September 13, 2002, memorandum, “Changes in Acquisition Rules,” the Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics stated that “DCMA’s contract management workload is growing and at the same time budget pressures are forcing significant reduction in resources. If we let that trend continue, we would experience general deterioration in the quality and timeliness support that DCMA provides.”

## Summary

We compared the inspection requirements for procurement activities and expectations of source inspections with actual results of the source inspections. We also reviewed Federal, DoD, and local policy, if any, and compared those policies with decisions rendered for inspection at source. We summarized the following factors as the primary impediments to consistent and accurate decisions to request a Government source inspection:

- Product Unawareness. We observed that procurement personnel were, at times, unaware of the item they were procuring or of the item itself, its function, and its relationship with a major end item, if applicable.
- Item Criticality. We documented that items were categorized as critical with no basis or rationale as to their criticality.
- Extent of Inspection. We learned that, although a source inspection was requested, the procurement personnel were not aware of the type of inspection that was expected or could be conducted based upon information or key characteristics provided to the DCMA quality assurance specialist.

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- Linkage between DoD Users and Procurement Activities. We documented breakdowns among DoD Program Offices, end users, and technical and engineering support personnel in responding to and conveying the rationale for and expectations of a Government source inspection to the procurement activities.
- Future DoD Quality Assurance and Procurements. Current and future DoD procurements are changing from rigid military specifications to commercial products. Accordingly, the DoD quality assurance program could free up limited DCMA resources that can be applied to critical, complex items requesting and deserving a higher level of inspection.

Communication improvements between the DoD procurement community and DCMA will minimize or eliminate unnecessary source inspections. DoD can then appraise the quality assurance program to determine the most efficient placement, use, and function of its quality assurance specialists.

## **Recommendations, Management Comments, and Audit Response**

- 1. We recommend that the Under Secretary of Defense for Acquisition, Technology, and Logistics:**
  - a. Define exactly what is involved and expected from the conduct of both Government source inspections and destination inspections.**
  - b. Develop specific uniform criteria as to what constitutes a critical and noncritical item.**
  - c. Develop a policy that addresses the need for conducting source inspections for commercial items and items purchased from distributors.**
  - d. Prohibit source inspections for commercial-off-the-shelf items.**
  - e. Require that DoD procurement activities respond to DD Form 1716, “Contract Data Action Recommendation/Deficiency Report,” in a timely manner.**
  - f. Determine the need for the use of both the Certificate of Conformance and Alternate Release Procedure methods.**

**Management Comments.** The Under Secretary of Defense for Acquisition, Technology, and Logistics did not comment on Recommendation 1. We request that the Under Secretary of Defense for Acquisition, Technology, and Logistics provide comments in response to the final report.

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## 2. We recommend that the Director, Defense Contract Management Agency:

- a. Perform a risk-based analysis and determine if specialists at major Defense contractors at in-plant locations could be better used inspecting and evaluating supplies and services of new contractors, small contractors, and contractors with a history of poor quality.**

**Management Comments.** The DCMA partially concurred with Recommendation 2.a. and stated that it continuously monitors quality assurance resources and assesses workload demands at both resident and non-resident activities. The Agency also stated that proposed changes in business rules limiting source inspection activity will further refine resource allocations, including new contractors and contractors with a history of poor performance.

**Audit Response.** What we wanted to achieve with the recommendation was to have the resources allocated to those entities most likely to experience quality problems. During the audit, we found large numbers of personnel working at resident activities that had a good quality history. The DCMA comments indicate that it shares our concern and ongoing changes in DoD business rules will more clearly focus quality resources. Accordingly, the Agency's comments meet the intent of the recommendation.

- b. Require that the DD Form 1716, “Contract Data Action Recommendation/Deficiency Report,” is used for contracts that involve a requested change from source to destination inspection.**

- c. Establish metrics identifying procurement activities that participate and that do not participate in responding to DD Form 1716, “Contract Data Action Recommendation/Deficiency Report,” inquiries and report those activities that do not participate to higher management for follow-up action.**

**Management Comments.** The DCMA partially concurred with Recommendations 2.b. and 2.c. and stated that proposed regulatory changes in the Defense FARs will emphasize recognition of changes to source inspections during the contract pre-award phase. The Agency stated that DoD has noted ongoing concerns with nonresponsiveness to reported contract deficiencies, including unnecessary source inspections, and will incorporate an automated contract deficiency reporting and resolution system to the DoD Wide Area Workflow system. This new addition will allow DoD users to record, report, approve, and resolve contract deficiencies. The reporting system will also produce management reports that can be used to identify systemic contract deficiencies. DCMA will establish metrics to gauge how deficiencies are resolved.

**Audit Response.** Active identification of unnecessary source inspections during the contract pre-award phase will curtail the necessity of addressing them during contract execution as a contract deficiency. If DoD regulatory changes limiting source inspections are adhered to, source inspections will be implemented to only

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the highest risk procurements. The DCMA proposed actions meet the intent of Recommendations 2.b. and 2.c.

**d. Instruct quality assurance specialists on how and when to implement Certificate of Conformance and Alternate Release procedures.**

**Management Comments.** The DCMA concurred and supplemented its Supplier Quality Assurance policy with an information memorandum dated March 10, 2003, addressing the use of Certificates of Conformance and Alternative Release Procedures.

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## Appendix A. Scope and Methodology

We analyzed whether Government source inspections were being performed on purchases that did not require them. From the Mechanization of Contract Administration Services database, we initially obtained 71,161 contracts for FY 2001 that specified a source inspection requirement. We sorted the universe to identify which Military Departments and DLA procurement activities managed the highest number of contracts in FY 2001 with a source inspection requirement.

We then selected the top three procurement activities at the three Military Departments and three DLA procurement activities for review. We randomly selected 30 contracts for review at the largest 12 DoD procurement activities. We also identified commercial contracts by researching applicable DD Form 350, "Individual Contracting Action Reports," for the 12 procurement activities and randomly selected an additional 30 contracts. Of the 12 procurement activities, 3 had fewer than 30 commercial item contracts; therefore, we selected all the commercial item contracts for those procurement activities. In total, we selected 705 contracts for review at the 12 largest DoD procurement activities. We then sorted the 705 contracts reviewed at the 12 DoD procurement activities by the DCMA field locations responsible for contract administration.

We identified 60 DCMA field locations and selected 10 locations to visit. We transmitted contract data to the remaining 50 DCMA locations. During our review at the DoD procurement activities and at the DCMA field locations, we learned that 187 of the 705 contracts erroneously cited inspection at source; did not have contract or inspection information available for review; were not FY 2001 contracts; or were cancelled. We eliminated the 187 contracts that resulted in 518 FY 2001 contracts requesting source inspection remaining in our sample.

The 518 contracts were comprised of 139 Army contracts, 102 Navy contracts, 136 Air Force contracts, and 141 DLA contracts. We reviewed the contracts and interviewed engineering and contracting personnel at 12 procurement activities that we visited. We also visited 10 DCMA locations that provided contract administration for 255 of the contracts we reviewed. At the 10 DCMA locations, we interviewed 156 quality assurance specialists to determine the type and extent of the source inspection conducted. We also electronically contacted an additional 37 DCMA locations to obtain source inspection information for 263 contracts.

We evaluated the rationale for requesting inspection at source at the 12 DoD procurement activities we visited. We discussed the rationale of the decision with contracting personnel as well as program office and engineering support personnel. We reviewed local policy, if any, and compared that policy with decisions rendered for inspection at source. We also determined if the procurement activities established and enacted any policy for eliminating unnecessary source inspections.

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We interviewed quality assurance specialists and team leaders responsible for contract administration of the contracts for the 10 DCMA locations we visited. For both the DCMA field activities visited and the DCMA locations we contacted, we obtained the DCMA-assigned risk rating of the contractor; the depth and extent of the source inspection; any deficiencies noted with the source inspection; any history of deficiencies with the contractor for the items procured in the contract; and the time and the distance traveled, if any, to conduct the source inspection. We reviewed the records specialists maintained for the contracts they administered, which included drawings, contractor appraisals, noted deficiencies, and any sampling plans incorporated by the specialist to select and test items for inspection. We also documented any problems the specialists expressed that impeded or negated an effective and meaningful Government inspection at source.

We performed this audit from July 2002 through April 2003 in accordance with generally accepted government auditing standards. Our review did not include reviewing contracts administered by the Military Services, only contracts administered by DCMA. In addition, our review did not include the testing of the adequacy or effectiveness of the process-proofing inspection procedures or associated product audit employed by DCMA.

**Use of Computer-Processed Data.** To achieve the audit objectives, we initially used computer-processed data contained in the Mechanization of Contract Administration Services and the Individual Contracting Action Report databases. We determined that FY 2001 contract data maintained on the systems was partially inaccurate and not fully reliable. However, because of the availability and reliability of the corresponding FY 2001 contract files and DCMA personnel internal records for 518 of the contracts that we selected from the databases, we were able to draw accurate conclusions.

**General Accounting Office High-Risk Area.** The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the DoD high-risk area to “Improve processes and controls to reduce contract risk.”

## Management Control Program Review

DoD Directive 5010.38, “Management Control Program,” August 26, 1996, and DoD Instruction 5010.40, “Management Control Program Procedures,” August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

**Scope of the Review of the Management Control Program.** We reviewed the adequacy of management controls addressing unnecessary Government source inspections at 12 DoD procurement activities and 10 DCMA field locations. Specifically, we reviewed the management control plans at each location

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pertaining to supplier quality assurance. We reviewed management's self-evaluation applicable to those controls.

**Adequacy of Management Controls.** We identified a material management control weakness, as defined by DoD Instruction 5010.40, involving the use of DD Form 1716. The DD Form 1716 was used to note quality assurance procedural deficiencies and document the rationale for changes from source to destination inspection. DCMA widely discontinued the use of the report. In addition, procurement activities rarely responded to reports submitted by DCMA. Recommendations 1.e., 2.b. and 2.c., if implemented, will provide additional opportunity for the DoD procurement activities and DCMA to jointly identify and agree upon unnecessary source inspections. A copy of the report will be provided to the senior official responsible for management controls at DoD procurement activities and at DCMA.

**Adequacy of Management's Self-Evaluation.** The 12 DoD procurement activities we visited did not identify the Government source inspection process as an assessable unit; therefore, the activities did not report material management control weaknesses addressing this quality assurance function. DCMA did identify material management control weaknesses addressing source inspections at 6 of the 10 DCMA locations we visited. The specific functions listed below are portions of the Quality Assurance processes outlined in the DCMA *One Book* and selected DCMA offices that we considered:

- Risk Planning - Contracts and related customer directions reviewed to gain a clear understanding of customer needs.
- Risk Assessment - Assigning the risk rating to each key process supported by the data such as process proofing.
- Risk Handling - For low risk processes, use data analysis as the primary method of handling and performing product audits to maintain confidence in the accuracy of contract data. It also includes evaluating contractor quality systems for compliance with contractual higher-level contract requirements, surveillance techniques, and critical application.
- Risk Monitoring - The degree of risk with the contractor based on cost, schedule, and the technical risk inherent in the selection process, which might affect the successful delivery of product or service.
- Risk Documentation - Requires that quality assurance specialists, performing surveillance, maintain proper documents, and be available for review.

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## Prior Coverage

### Inspector General of the Department of Defense (IG DoD)

IG DoD Report No. D-2002-013, "The Defense Supply Center Richmond Qualified Products List Program," November 2, 2001. The report states that the Defense Supply Center Richmond could not conduct facility audits, adequately maintain the Qualified Products List of Government designation status and qualified manufacturers, or monitor related product deficiencies. As a result, the Government could not obtain the benefits of the Qualified Products List Program, one of which is the elimination of source inspection requirements for items procured from suppliers currently in the program.

### DLA

Defense Supply Center Columbus, Internal Review Report No. 26-00, "Compliance Review of the Origin Inspection Determinations," May 18, 2000, states that DoD acquisition reform initiatives resulted in efforts that would eliminate unnecessary requirements for Government inspection at source. The Internal Review office took a random sample of 315 items identified as requesting a Government source inspection. The internal review office interviewed 48 quality assurance specialists to obtain the justification of Government source inspection for 315 items. As a result, 40 items were changed to destination inspection and an additional 29 items were identified as potential candidates for destination inspection once additional procurement history was established. Government source inspection did not comply with the supply center's source inspection guidance.

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## **Appendix B. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense (Comptroller)/Chief Financial Officer

Deputy Chief Financial Officer

Deputy Comptroller (Program/Budget)

Under Secretary of Defense for Acquisition, Technology, and Logistics

Director, Defense Procurement and Acquisition Policy

Deputy Under Secretary of Defense for Logistics Materiel Readiness

Director for Acquisition Initiatives

### **Department of the Army**

Assistant Secretary of the Army (Financial Management and Comptroller)

Auditor General, Department of the Army

Commander, Army Materiel Command

### **Department of the Navy**

Naval Inspector General

Auditor General, Department of the Navy

Commander, Naval Supply Systems Command

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)

Auditor General, Department of the Air Force

Commander, Air Force Materiel Command

### **Defense Agencies**

Headquarters, Defense Contract Management Agency

Commander, Defense Contract Management Agency, East

Commander, Defense Contract Management Agency, West

Headquarters, Defense Logistics Agency

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## **Non-Defense Federal Organizations and Individuals**

Office of Management and Budget

### **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on Defense, Committee on Appropriations

House Committee on Armed Services

House Committee on Government Reform

House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform

House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform

House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform



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# Defense Contract Management Agency Comments



IN REPLY  
REFER TO DCMA-OC

DEFENSE CONTRACT MANAGEMENT AGENCY  
8350 WALKER LANE, SUITE 300  
ALEXANDRIA, VIRGINIA 22310-3226

OCT 2 2003

MEMORANDUM FOR DEPUTY DIRECTOR, CONTRACT MANAGEMENT DIRECTORATE,  
DOD INSPECTOR GENERAL

SUBJECT: Draft Report on Government Source Inspections (Project Number: D2002CF-0169)

The attached is provided for consideration relative to the recommendations contained in paragraph two of the "Recommendations" section of the subject report. We appreciate the opportunity to comment on the draft report. Should any questions or comments arise, please contact Mr. Mark A. Young at (703) 428-0956.

A handwritten signature in black ink, appearing to read "RW Schmitt".

ROBERT W. SCHMITT  
Executive Director  
Contract Management Operations

Attachment

2. We recommend that the Director, Defense Contract Management Agency (DCMA):

a. Perform a risk-based analysis and determine if specialists at major Defense contractors at in-plant locations could be better used inspecting and evaluating supplies and services of new contractors, small contractors, and contractors with a history of poor quality.

**DCMA COMMENTS:** Partially Concur. The DCMA does not concur that a one time risk based analysis is needed at this time. DCMA uses a continuous risk based approach to assure that resources are effectively deployed. The Agency continually assesses work load demands at both resident and non-resident activities and focuses efforts on value-added quality assurance services. Recent changes, proposed by the PDUSD(AT&L), in acquisition business rules limiting source inspection activity will serve to further refine resource allocations. The changes will focus DCMA quality assurance resources. The criteria for source inspection contain specific acquisition concerns; including new contractors and contractors with a history of poor performance. This approach, coupled with risk-based surveillance, will assure that DCMA resources are allocated appropriately. To further refine resource allocations, the Agency is striving to link labor expenditures accumulated through Activity Based Cost efforts and supplier risk information detailed in its Risk Assessment and Management Program.

b. Require that the DD Form 1716, "Contract Data Action Recommendation/Deficiency Report," is used for contracts that involve a requested change from source to destination inspection.

**DCMA COMMENTS:** Partially Concur. The DD Form 1716 is the specified method for correcting contract deficiencies in the post-award environment. This Agency views use of the DD Form 1716 in the post-award environment as reactionary. The appropriate time to designate inspection and acceptance locations is prior to contract award. Pending DFARS language is intended to limit inspection at source by influencing the decision making process during the pre-award phase. Pending these changes, the DD Form 1716 is the official method for noting contract deficiencies, including deficient point of acceptance or acceptance determinations. The current DCMA policy notes "contract deficiencies discovered by DCMA after contract award should be discussed with the contractor when appropriate, and reported by the most efficient means (e.g., e-mail, DD Form 1716) to the Administrative Contracting Officer/Procurement Contracting Officer for official resolution." Inability to resolve deficient point of acceptance or acceptance determinations through this formal notification has resulted in dwindling use of the DD Form 1716 and was a significant factor in designing a policy of reporting through the "most efficient means." DoD has noted ongoing concerns with non-responsiveness to reported contract deficiencies. The DoD Wide Area Workflow (WAWF) Joint Requirements Board (JRB) Co-chairs have agreed to add a contract deficiency reporting and resolution system to WAWF. The new system will allow DoD users to electronically generate contract deficiency reports and route the reports for approval and resolution. The new system will also produce reliable contract deficiency management reports that can be used to identify systemic contract deficiencies. The joint

system requirements were provided to the JRB in October 2002. The JRB has not established a schedule for the new system deployment.

c. Establish metrics identifying procurement activities that participate and that do not participate in responding to DD Form 1716, "Contract Data Action Recommendation/Deficiency Report," inquires and report those activities that do not participate to higher management for follow-up action.

**DCMA COMMENTS:** Partially Concur. Should it be determined, through the activities described in recommendation 2.b. above, that DD Form 1716 or a comparable electronic version should be utilized, DCMA will establish metrics to gauge their effectiveness.

d. Instruct quality assurance specialists on how and when to implement Certificate of Conformance and Alternate Release procedures.

**DCMA COMMENTS:** Concur. DCMA has generated an Information Memorandum, dated March 10, 2003, attached to the Supplier Quality Assurance policy concerning the use of Certificates of Conformance and Alternate Release Procedures during contract management activities.

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## Team Members

The Contract Management Directorate, Office of the Deputy Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

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